

TESTIMONY OF ATTORNEY GENERAL GALE NORTON
REGARDING THE CIVIL LIABILITY PROVISIONS OF THE PROPOSED NATIONAL
TOBACCO SETTLEMENT

SENATE COMMERCE COMMITTEE

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Thank you, Mr. Chairman and members of the committee, for this opportunity to discuss with you today the proposed resolution of litigation with the tobacco industry. This is an historic opportunity to adopt a plan which will alter the way in which the tobacco industry conducts business in the United States, will eliminate the marketing of tobacco products to the youth of our country, and will provide compensation for the past misconduct of the industry.

I support the June 20th agreement. While not perfect, it embodies the states' efforts - efforts without which there could be no discussion of legislation today. I hope that Congress will concur and enact comprehensive legislation similar to that offered by Senators McCain and Hatch. Their bills address all the issues in the June 20th agreement and are preferable to piecemeal legislation which may not resolve the pending litigation nor achieve broad public health and regulatory goals.

The June 20, 1997 proposed national tobacco settlement is a comprehensive plan to resolve pending litigation and establish a mechanism for claims by individuals to be compensated for injuries caused by the companies. The civil liability provisions are an integral and necessary

component of the settlement. Far from providing the industry with blanket civil or criminal immunity from past misconduct, the civil liability provisions assure that massive payments being made by the companies, including \$60 billion in punitive damages, can be collected and distributed for public benefit without the need for anyone to win a race to the courthouse.

As with any settlement, there has to be give and take by each side. An agreement of this type, to provide resolution to multi-state litigation and to ensure fundamental changes in how the industry does business, must have incentives for each side. The civil liability provisions provide the “quid pro quo” for other provisions of the settlement, most importantly the severe limitations on advertising which we propose to enforce through state court consent decrees and a Master Settlement Agreement. The advertising restrictions result in total elimination of many forms of advertising, including Internet advertising. The extent of these restrictions could not be achieved by legislation alone. The companies have agreed to them as part of the entire settlement package, but taken out of that context, the companies could challenge them as violative of their first amendment rights. What the companies got in return was not immunity, but certainty in planning for the financial impact of paying for damages and providing compensation to those injured.

Let me address a few misconceptions about the civil liability provisions of the settlement agreement. Immunity is a misnomer for the protections received by the industry. They receive no immunity from civil or criminal liability for past misconduct. The companies will be paying huge awards to the states for past illegal activities and to compensate the states for damages. They will remain subject to criminal charges, should the states or the federal government determine that

criminal activity was involved, or should there be any future criminal activity. Any individual who has suffered physical damage will also be able to bring suit against the tobacco companies, assisted by the full library of documentation which the companies will make available to the public.

The settlement resolves two types of claims by delivering the potential relief in a national way. The settlement provides that \$60 billion in punitive damages would be used to benefit the public as a whole, rather than rewarding a few lucky individual litigants. Claims based solely on addiction, that is, suits seeking funding to help addicted smokers kick the habit, are ended because the settlement provides billions of dollars for smoking cessation programs.

The most important aspect of the civil liability provisions is that it eliminates the “race to the courthouse” atmosphere for litigating or settling pending and future cases. If left to the tort system, a handful of large judgments could force the companies, or some of them, into bankruptcy, leaving the remainder of the injured plaintiffs empty-handed or spending years in line with other creditors hoping to be paid.

In the past few months the industry has entered into courthouse-steps agreements with three states and a class of flight attendants. Together these settlements total about \$30 billion. Payments, however, are spread over 25 years. If the industry had gone to trial and faced immediate judgments for the same dollar amount, the financial stability of the industry, or at least some of the defendants, would be in doubt. According to the Sanford and Bernstein Estimates of

Profits and Losses (Summary January 29, 1998), the 1997 profits for six companies involved in litigation were \$7.8 billion on revenues of \$22 billion. It is easy to see that enforcing the magnitude of judgments potentially due to all forty litigating states, as well as to individuals, local governments, unions, insurance companies, and Indian tribes over the next few years would render the industry insolvent, leaving many of the judgments unpaid, discharged, or frozen in a reorganization plan for many years. At the very least, the industry would lose its weaker competitors, leaving it even more concentrated.

By contrast, the settlement provides for an orderly and financially sound mechanism to assure payment by the industry of damages to the states and for federal programs which are designed to reduce youth smoking. The industry would have a “ramp-up” period of payments, then would pay \$15 billion per year from 2008 on. (For the sake of simplicity, the numbers used in this testimony are not adjusted for inflation and sales volume. The agreement requires that the actual payments be adjusted, including an inflation factor of at least 3% per year.) Given what we know about the current financial position of the companies, these payments will not be insignificant to their operation, but will not render them insolvent.

The industry can withstand the huge financial liability contemplated by the settlement if it is structured over a long period of years, but not if a number of cases go to trial and result in judgments coming immediately payable. All of the states deserve the kind of settlement the first three states have obtained. As has been learned from the asbestos litigation, if we don’t control

how litigation is brought, and structure the payments to fit within what is financially feasible for the companies, the results will be uneven and inequitable.

It is understandable that many public health advocates feel that the “capital punishment” of bankruptcy is a fitting end for producers of a product that kills 425,000 people annually. Yet, the people who would be most hurt by such a result are the injured smokers and their families. If the existing companies declare bankruptcy, and new companies are formed to take their places, the new companies would bear no responsibility for the misconduct of the old companies, and would not be liable to pay damages. The corporate documents that have been revealed to the public in the last few months would be worthless against new companies, and we will wait many more years before an opportunity arises such as the one presently before us. The civil liability provisions as a whole, rather than benefiting only the tobacco companies, are also of great benefit to the states and individual claimants.

Of course, complete liquidation is not the only bankruptcy scenario for tobacco companies, because the companies may seek reorganization so they could continue to operate. Even reorganization, however, is based on the fundamental goal of giving the debtor a “fresh start.” This would include some way of resolving the companies’ exposure, in a way that might, or might not, satisfy injured smokers and other claimants.

Public health advocates have recently argued that a bankruptcy court will be able to achieve many of the goals of the settlement, including elimination of hazardous products and

disclosure of health research, and will also be able to impose international controls on the business operations of the companies. This rosy picture distorts the role of a bankruptcy court, which is to administer the provisions of the Bankruptcy Code and Rules.

The Bankruptcy Code is ill-suited to accomplish broad public health objectives. Bankruptcy judges are generally highly qualified to deal with the financial issues arising in cases before them, but they rarely have experience in addressing broad social objectives. The settlement package includes a wide array of provisions that will address tobacco public health concerns, and the settlement process ensures broad participation in shaping the final results, including participation by Congress, the White house, the FDA and other interested federal agencies, the states, public health groups, and other stakeholders. It is entirely unrealistic to suggest that the public health remedies and the approval and implementation process of the settlement should be replaced by the provisions of the Bankruptcy Code and the power of a single bankruptcy judge.

Moreover, the “race to the courthouse” is only one of the problems that would confront state and other tobacco victims in bankruptcy court. Even the winners of the courthouse race would lose if the assets brought into bankruptcy are inadequate to pay claims, and there is no assurance that tobacco companies would bring their large present assets into bankruptcy court. The negative climate confronting the tobacco market today may well cause companies to restructure and to shift assets away from tobacco operations to more profitable areas. Companies may file bankruptcy with all of their tobacco liabilities but few of their assets. This was the picture

presented by asbestos plaintiffs, who alleged that the parent of the Celotex asbestos company had stripped the firm's assets to avoid the reach of asbestos claims. But the bankruptcy court had ruled that the restructuring was justified given business considerations and that the victims could not reach the assets. Hillsborough Holdings Corp. v. Celotex Corp., 166 B.R. 461 (Bankr. M.D. Fla. 1994). Enactment of the settlement agreement as a total package provides incentive to the companies to abide by the financial arrangements of the agreement rather than to take other, less beneficial, options.

Some public health advocates urge that bankruptcy of these companies will result in tobacco products simply not being manufactured in the United States. As an advocate of individual choice and personal responsibility, I do not favor banning tobacco use by informed adults. Moreover, I think it is naive to assume that 40-50 million current addicted smokers in the United States will simply quit using tobacco products. As the country experienced during Prohibition, it is more likely that a ban will result in illegal trafficking and smuggling of the product. Contraband dealers are not going to be subject to federal, state or local regulation, will not be concerned with preventing youth from having access to products, and are certainly not likely to be easily brought into court to compensate those injured.

Canada experienced similar problems when it dramatically increased tobacco taxes, with resulting price increases, in an effort to curb tobacco use. Canadian authorities estimated that at one time, up to 90% of the Canadian cigarette exports to the United States were eventually smuggled back into the Canada. The flagrant smuggling forced Canada to switch its priority from

public health to crime fighting. Its small businesses were hurt. There was no dramatic decrease in the number of Canadians who smoke.

When originally instituted, Canadian authorities and anti-smoking advocates fully expected the increased taxes to reduce smoking. Accordingly, in 1994 when the government sought to reduce cigarette taxes - as a means of ending the massive smuggling efforts and associated criminal activities - the government met with stiff opposition from the anti-smoking community. The anti-smoking community expected the decreased taxes to result in a significant increase in smoking. This fear was not borne out, and indeed, tobacco production overall decreased after the tax rollback. Importantly, reducing the exorbitant taxes on tobacco effectively shutdown the massive black-market for the product.

The Canadian experience with the smuggling of contraband is directly on point with the efforts of some to drastically increase tobacco prices overnight. In addition, those who would discount Canada's problems with limiting access to cigarettes should consider the United States' efforts to ban alcohol. The Eighteenth Amendment, the resulting bootlegging and sale of alcohol by organized crime, Americans' disgust with overregulation, and the culmination in the enactment of the Twenty-First Amendment are monuments to those with good intentions who failed to consider the long-term consequences of their actions.

Let us not forget that the bane of local, state and federal law enforcement in this country for over half a century, organized crime, got its start during Prohibition. If we increase prices of

tobacco products too quickly through dramatic tax increases, we run the risk of giving rise to a whole new criminal organization - which law enforcement officials will be combating for years after the debate on tobacco has been resolved. Such a result is counter-productive and unnecessary if Congress will instead legislate a program as envisioned by the settlement, where prices increase gradually, tobacco products remain available to those who choose to continue using them, and payments by the industry are available for anti-smoking campaigns, cessation programs, and compensation to those injured.

Let me address a few specific provisions within the civil liability section that have drawn fire from critics. Great emphasis has been placed on the fact that punitive damages will not be available to individual claimants for past actions by the companies. That is true. It is important to remember two things. The first is that punitive damages are limited in many states right now, under current state laws. The second is that punitive damages are intended to punish a defendant for wrongdoing. I submit that the total payments of the companies, combined with the unprecedented regulation of advertising, manufacturing, corporate culture, and the highest potential penalties for noncompliance ever levied against an industry, are punishment equal to whatever punitive damages might be imposed by the courts in this country. Moreover, any individual may ask for punitive damages for any illegal future conduct of the companies.

Another major issue raised by critics has been the elimination of class actions. In weighing whether the bargain struck by the Attorneys General was a good one, we need to consider the reality of class actions. On the positive side, a class action can be a useful tool in

cases where all the members of the class suffered the same injury or damage in a like factual setting. Class actions against the tobacco companies based on addiction and dependence claims, which seek funding for smoking cessation programs or medical monitoring for smokers who have not yet manifested a tobacco-related disease, are an effective mechanism and have been certified by several courts. These class actions will not be necessary, however, because the companies have agreed to provide funding for these kinds of remedies.

Where smokers are already suffering from lung cancer or emphysema and seek medical expenses, class actions are more problematic. Courts have generally required these larger, and more individualized, claims, much like asbestos claims, to be tried individually because of the lack of commonality among plaintiffs' experience, injuries, and degree of reliance on tobacco industry statements regarding health effects of the products. In bargaining for the settlement, the Attorneys General recognized the practical difficulty in getting these kinds of claims certified by the courts. The negotiating Attorneys General took this into account when they balanced the settlement's public health benefits against the industry's demands.

The settlement does permit consolidation of cases for pretrial proceedings and discovery. This will allow plaintiffs to share costs as much as possible. Additionally, the companies will be placing millions of documents into a national depository for use by the public. These documents would presumably be accessible by computer soon. With this computerized access to evidence, most plaintiffs will be able to present a case at trial with much less expense.

Congress should also consider the potential abuses that may result from use of class actions. An individual has little control over the disposition of a class action. If the stakes were high, most of us would be troubled to find out that we were covered by a class action filed without our knowledge or participation in a remote court, far from our home, and that a settlement of that case had bargained away our right to file suit. For example, if an individual has \$100,000 in injuries, but is included in a class action which is settled for \$10,000 per person, without input or approval by each member of the class, the class action may have hindered rights, rather than being of benefit. Even if the class action is not a “sweetheart deal,” it may still not provide the direct compensation an individual might seek. The recent settlement of a flight attendant class action in Florida has been criticized on similar grounds, and a class action in Alabama is now considering binding all smokers nationwide with any claims against the Liggett Company for mere pennies on the dollar. Thus, while critics of the settlement point to the limitation on class actions as a major flaw of the agreement, in fact, class actions have both positive and negative aspects. The settlement is a reasonable compromise.

Earlier this month, before the House Judiciary Committee, I urged adoption of a provision that would create a federal cause of action for individuals who suffer injury from material violations of the federal law enacted to implement the settlement. Thus, if a tobacco company mislabels its product, or fails to disclose an ingredient, and the failure results in harm to an individual, compensation would be available to the individual. This is in addition to the powers of the state and federal governments to enforce the terms and conditions of the settlement’s statute, agreements and consent decrees. This “enforcer” provision is consistent with the

framework of the June 20th agreement, and should help resolve some of the concerns that have arisen about the civil liability provisions.

One important result of the settlement should be technological progress toward reduced-risk tobacco products. Many state lawsuits allege that, in the past, tobacco companies faced the prospect that safer products would be used as damaging evidence in court cases. As a result, the companies suppressed the normal competitive practices that would have ensured better, safer technology for consumers. The civil liability provisions of the settlement address this by eliminating the use of the fact of development of reduced risk products as evidence against the industry in future lawsuits. This provision removes the barrier to development of less harmful cigarettes, and should benefit those consumers who, despite full disclosure, elect to continue smoking.

There has been considerable confusion about the payments and expenditures contemplated under the settlement. The Attorneys General who negotiated the settlement attempted to walk a fine line, understanding that their role did not allow them to dictate to Congress how to spend federal money. However, it was certainly never contemplated that all the money paid under the settlement would be federal money. My colleagues and I did not bring our lawsuits to benefit the federal coffers, but to seek compensation and penalties for our states for damages resulting from illegal activities of the tobacco companies. The settlement is the basis for settling the states' lawsuits, therefore, the payment plan, however formulated, should provide some compensation directly to each state.

Let me explain how the settlement anticipates money will be paid by the companies and distributed. The settlement anticipates a “ramp-up” of payments by the industry over several years. This ramp-up allows the companies to gradually increase the price of tobacco products to generate the funds for the payments. Let us use year 10, at the end of the ramp-up period, as an example of how payments would be made from year ten on. Keep in mind that while a 25-year period of payments has been used by the Attorneys General, the industry, and the press to quantify the magnitude of the payments to be made under the agreement, the settlement contemplates that payments will be made in perpetuity. Thus, the \$368 billion figure commonly referenced is a 25-year total, but does not reflect a total or cap on the payments which will be made in perpetuity.

In year 10, the total industry obligation is \$15 billion. In reality the industry may pay \$16 billion because the companies receive credit for only 80% of the judgments and settlements they pay. The 80% credit does not reflect a subtraction from the total amount the companies will pay, but instead reflects that the companies only get credit for 80% of the judgments they pay through the tort system. Thus, the companies actually pay more, not less, than the base payment if they pay judgments or settlements to individuals.

The settlement contemplates that the companies will each pay into a trust fund to be established. The trust would then distribute the funds due to the federal government and to the states. The allocation of the money in year 10 would then be as follows: \$4 billion would be allotted as the tort system payment. Because this number represents the 80% credit to the companies for the judgments or settlements they have paid, the companies could actually pay up to \$5 billion to litigants. On the other hand, if there are not enough judgments and settlements to use the \$4 billion, any remainder will be paid to the equitable trust fund.

The equitable trust fund, with members appointed by the President, would then distribute those funds to entities not entitled to sue. As noted above, we anticipate these entities would include hospitals, local governments, unions, insurance companies, and so forth. In over thirty years of litigation with the industry, the companies have yet to pay any individual damages as a result of a tort system claim. While the settlement amply

provides for this scenario to change by dedicating money to individual judgments and settlements, if the tort system does not result in those judgments and settlements, the tobacco companies will still pay billions of dollars to compensate those outside the tort system.

Of the remaining total payment, \$8 billion would go to the states, and \$3 billion would go to the federal government, for use in whatever programs Congress deems appropriate. The settlement recommends allocation to counter-advertising, cessation programs and FDA enforcement. During the ramp-up years, the amounts paid to the tort system are less, reflecting the lead time necessary for suits to be filed, tried or settled, and more money is directed to federal programs, reflecting more immediate needs for cessation and youth programs. (The total allocation to the states anticipated by the settlement is \$196.5 billion over 25 years.)

What will happen if Congress does not enact legislation implementing the entire comprehensive settlement? I have outlined my concerns related to bankruptcy and the uncertainty that the states will be compensated in an even and equitable manner. Let me also discuss the uncertain results in law we will experience. Many insurance companies, unions, hospitals, and local governments are considering suits against the tobacco companies. There are many common threads or themes to the suits, but they are each somewhat unique. The settlement would resolve all of these suits without expanding upon or altering the tort law in our country. The impact of the tobacco litigation would not be reflected in caselaw applicable to other industries or defendants. If the tort system disposes of this litigation, state by state, case by case, the result will be wide variances in tort law created in each state, which may have long term impacts on our litigation system, and on other products in interstate commerce. There may be a strong incentive

for some judges to alter tort law to punish tobacco companies - and this may inadvertently affect other types of businesses' products liability exposure.

The public health benefits which would flow from continued litigation will be vastly divergent as well. Though some revisions may be legislated, the time lag in achieving the reductions in youth smoking and the lack of uniformity in advertising restrictions will impede the efforts to educate our youth about the dangers of smoking.

Certainly, we can assume that some cases will settle, others will go to trial. Some cases will be lost at trial, others will be won. This uneven result is not in the public benefit. If one state settles and incorporates advertising restrictions in the settlement, but its neighbors lose at trial, the benefits of the advertising restrictions may be lost, as border town kids obtain tobacco products from the neighboring states, or are influenced by media originating in another state.

This is a comprehensive settlement that should be enacted as a whole. While the settlement represents a compromise, it reflects the need for an organized, national consistency in dealing with tobacco litigation and future business practices and marketing. It will ensure that all those who should be compensated are, not just those who win the race to the courthouse. It provides public health benefits, preserves the free market system and federalism, and recognizes the right of adults to hear about the dangers of smoking and to make an informed choice. I urge Congress to carefully consider the proposed settlement, as a whole, and to implement it as a whole, to ensure the greatest benefit for the public and the most significant reform to the industry.

